



Office of the Under Secretary of Defense (Comptroller)
Financial Improvement and Audit Readiness Directorate

Office of Management and Budget Circular A-123, Management's Responsibility for Internal Control

Appendix A, Internal Control over Financial Reporting

May 16, 2006

Agenda

- Background
- Requirements
- Implementation Approach
- Report
- Deliverables
- Benefits

Background

- Office of Management and Budget (OMB) revised Circular A-123 and added Appendix A to strengthen the process over financial controls over financial reporting
- Appendix A is OMB's response to new control requirements over financial reporting for publicly traded companies contained in the Sarbanes-Oxley Act of 2002
- Provides new internal control standards
- **Defines prescribed process for conducting assessment of internal control over financial reporting**

Requirements

- Senior-level involvement (SAT)
- Review end-to-end business processes
- Identify risk and related control
- Perform control analysis
- Report on control weaknesses via new statement of assurance on internal control over financial reporting
- Correct weaknesses
- Assert to level of confidence

Senior Assessment Team

- Follow DoD guidance for reporting categories
- Identify material business lines/processes
- Narrate and flowchart business process
- Identify risks and assess materiality
- Document and test internal controls
- Report on control effectiveness
- Develop corrective action plans
- Assert level of assurance
- Monitor and report on correction progress

DoD Senior Assessment Team

- DoD SAT determined:
 - SAT membership
 - Functional experts
 - Decision makers
 - Scope: focus areas = > 78% DoD assets
 - Materiality level: .99% adjusted assets
 - Implementation guidance

Review End-to-end Business Processes

- Key business processes are narrated and flowcharted in order to perform risk assessments
 - **Trace transaction from point of origination through financial reports and back again**
 - Will require participation of those with knowledge of business processes/ transactions
 - **Do not rely on existing written procedures**
- Identify Risk and related controls
- Key business process flowcharts are evaluated to identify high risk areas which could result in material financial reporting misstatement

Perform Control Analysis

- Key Internal Controls which mitigate high risks are identified and evaluated for effectiveness
- For controls believed to be ineffective, corrective actions are prepared and implemented
- Controls believed to be effective are tested for effectiveness

Testing

- Develop and documented test plan:
 - Determine personality of sample (complexity, volume, geographic dispersion)
 - Determine universe
 - Determine sample size
 - Determine tolerance level
 - Determine test method (interview, inspect, observe, re-perform)
- Test (Who will test?)
- Report on results using forms on website

Report on Control Effectiveness

- Appendix A requires a separate statement of assurance on the effectiveness of internal control over financial reporting
- Report will be included in the FMFIA Annual Statement of Assurance and will be published in the PAR
 - Report **material** risks resulting from analysis performed by staff
 - Use form on public website
 - Address risk to management assertions:
- **Material:** affects decision of prudent person

Management Asserts

- **C**ompleteness
- **O**bligations/Rights
- **V**aluation
- **E**xistence/Occurrence
- **R**eporting/Presentation

Report on Control Effectiveness

- Report: Status and corrective action plans
 - Prescribed letter format
 - Unqualified
 - Qualified
 - No assurance
 - Tabs for discussion of weaknesses
 - Will be incorporated into Overall FMFIA SOA

Report on Control Effectiveness

- SAT approves:
- Management recommends:
 - Materiality of weaknesses:
 - Reportable condition?
 - Material weakness?

Correct Weaknesses

- Where control test results identify a material weakness, corrective action plans with target accomplishment dates will be developed and input into the DoD FIAR web-based financial improvement and audit readiness tool
- Progress must be monitored to ensure correction of weaknesses

DoD Incremental Approach

Incremental Approach: *2006*

WHO	WHAT
Reporting Entities	8 Focus Areas
Clean Opinions	All key processes
Asserting Entities	All key processes for lines being asserted

- **FY 2007: Accounts Payable, Accounts Receivable, Inventory, Operating Materials and Supplies**

DoD Incremental Approach

- Selected 8 focus areas for risk and control assessment
 - Funds Balance with Treasury*
 - Investments
 - Real Property*
 - Military Equipment*
 - FECA Liabilities
 - Environmental Liabilities*
 - Medicare Eligible Retiree Health Care*
 - Appropriations Received

* DoD Focus Area

DoD Incremental Approach (continued)

- Components which prepare stand-alone financial statements prepare deliverables congruent with Appendix A requirements
- OUSD(C) receives deliverables from Components
- DoD report will be a consolidation of Component reports

Required Deliverables

- Component deliverables
 - Business process flowcharts Dec 20, 2005
 - Risk analysis Feb 1, 2006
 - Internal control identification Mar 20, 2006
 - Test plans May 1, 2006
 - Test results and
Corrective action plans Jun 30, 2006
- DoD final report due Sep 1, 2006
- Published in PAR as a subset of
FMFIA Statement of Assurance Nov 15, 2006

Benefits

- **People will:**

- Meet people who are really responsible for your numbers
- People responsible for the numbers understand how they impact financial reports
- Understand how business is really done
- Identify areas for improvements
- Decide to redesign some processes
- Internal controls will get stronger
- Responsible for having more resources available through savings
- Be able to OBTAIN and sustain a favorable audit opinion.

For Additional Information

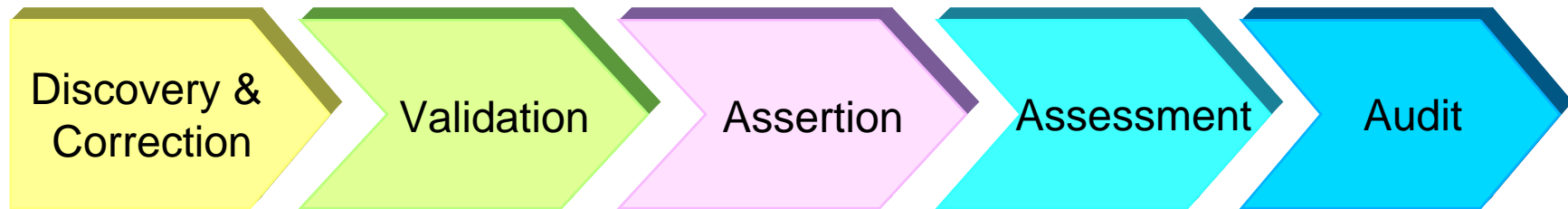
- OMB Circular 123, Appendix A, as revised in 2004
- GAO, Internal Control Management and Evaluation Tool (GAO-01-1008G)
- DoD guidance, issued November 8, 2005
 - Forms will be on Comptroller/FMFIA website
 - Provided examples
 - Web-based tool available on line
- CFOC issued OMB Appendix A implementation guidance, released July 2005



BACKUP



How the FIAR Plan is Executed – PHASED METHODOLOGY



Discovery & Correction: Deficiencies identified, corrective action plans added to FIPs in FIAR Planning Tool, progress tracked, and deficiencies corrected

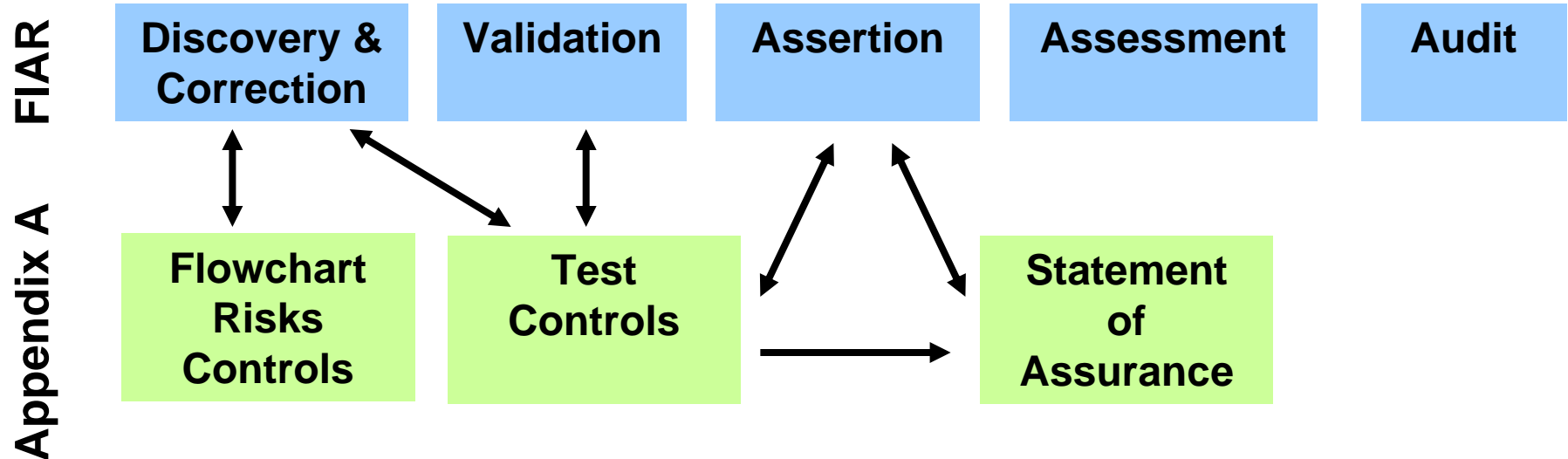
Validation: Management confirms corrective actions completed successfully

Assertion: Management asserts to OIG the reliability of financial information

Assessment: OIG performs limited review of controls and procedures to determine if ready for full audit

Audit: OIG audits the organization's financial information

Relationship Between FIAR Plan and OMB A-123 Process



Senior Assessment Team

SAT will: **Identify material lines**

CONSOLIDATED BALANCE SHEET	DoD-Wide	Army GF	Army WCF
	2005	2005	2005
	Consolidated	Consolidated	Consolidated
DoD materiality level (000)	7,102,889	7,102,889	7,102,889
Component materiality level (000)		1,623,755	173,321
1. ASSETS (Note 2)	(000)		
A. Intragovernmental:			
1. Fund Balance with Treasury (Note 3)			
a. Entity	\$ 289,003,700	86,799,034	623,330
b. Non-Entity Seized Iraqi Cash	61,400	61,370	-
c. Non-Entity-Other	1,592,000	232,913	-
2. Investments (Note 4)	263,367,800	3,495	-
3. Accounts Receivable (Note 5)	1,291,300	276,634	366,622
4. Other Assets (Note 6)	1,394,200	824,303	-
5. Total Intragovernmental Assets	\$ 556,710,400	88,197,749	989,952
B. Cash and Other Monetary Assets (Note 7)	\$ 2,072,700	1,482,046	-
C. Accounts Receivable (Note 5)	7,615,500	584,005	12,035
D. Loans Receivable (Note 8)	75,600	-	-
E. Inventory and Related Property (Note 9)	222,573,300	37,703,353	15,933,141
F. General Property, Plant and Equipment (Note 10)	460,699,300	120,401,746	1,228,213
G. Investments (Note 4)	605,000	-	-
H. Other Assets (Note 6)	23,822,100	3,844,524	333,741
2. TOTAL ASSETS	\$ 1,274,173,900	252,213,423	18,497,082

Senior Assessment Team

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Component materiality level (000)			1,623,755	173,321
3. LIABILITIES (Note 11)				
A. Intragovernmental:				
1. Accounts Payable (Note 12)	\$	2,058,000	1,918,309	105,603
2. Debt (Note 13)		467,100	-	-
3. Other Liabilities (Note 15 & Note 16)		11,150,800	2,372,261	75,579
4. Total Intragovernmental Liabilities	\$	13,675,900	4,290,570	181,182
B. Accounts Payable (Note 12)	\$	28,575,400	10,137,011	295,820
C. Military Retirement Benefits and Other Employment		1,736,057,800	1,663,650	286,523
Actuarial Liabilities (Note 17)				
D. Environmental Liabilities (Note 14)		65,027,600	39,760,514	-
E. Loan Guarantee Liability (Note 8)		41,100	12,394	-
F. Other Liabilities (Note 15 & Note 16)		29,985,400	6,401,916	642,522
4. TOTAL LIABILITIES	\$	1,873,363,200	62,266,055	1,406,047
5. NET POSITION				
A. Unexpended Appropriations	\$	271,493,600	74,704,745	-
B. Cumulative Results of Operations		(870,682,900)	115,242,623	17,091,035
6. TOTAL NET POSITION	\$	(599,189,300)	189,947,368	17,091,035
7. TOTAL LIABILITIES AND NET POSITION		\$ 1,274,173,900	252,213,423	18,497,082